WILSHIRE
CONSULTING

Michael C. Schlachter, CFA
Managing Director

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Mr. Russell Read
Chief Investment Officer
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: Affiliate Funds – Internationally Indexed Portfolio

Dear Russell,

You requested Wilshire's opinion regarding the internal management of the Affiliate Funds, currently managed by State Street Global Advisors. We agree with Staff's recommendation to manage these funds in-house and to pool them with the existing internal international equity index fund under the same guidelines.

There are several elements to this agenda item and this letter will address each separately.

First, internal management of the Affiliate Funds as part of the PERF's portfolio would require a benchmark change from EAFE to the FTSE All World Developed excluding US. In our opinion, these benchmarks are substantially the same in terms of sector and country weights (with the exception of Canada, as noted below) and historical performance, and there is no basis to expect that one should outperform the other over any meaningful period of time. The FTSE benchmark has been previously well-vetted and approved as the benchmark for the greater PERF portfolio, and we see no reason why it would not be a suitable benchmark for the Affiliate Funds.

Second, internal management of these portfolios would add exposure to Canada, which is currently missing in the SSGA portfolios. We believe that the exclusion of Canada (a developed market and a member of the G7 and NATO) from the EAFE benchmark is a historical anomaly which should be rectified by MSCI, and therefore we recommend the inclusion of Canadian equities in the Affiliate Funds portfolios.

Third, internal management of the Affiliate Funds would result in the exclusion of tobacco stocks from the portfolios. Tobacco stocks are currently included in the portfolios managed by SSGA. The CalPERS Investment Committee has previously determined that its benchmarks should be devoid of tobacco stocks, and the inclusion of such equities in the indexed Affiliate Funds has been a function of the fact that the passively managed portfolio options available at SSGA for these funds included tobacco stocks. SSGA does not offer commingled index funds in which the Affiliate Funds could have invested that exclude tobacco stocks. As a result, we believe that the exclusion of tobacco stocks in the Affiliate Funds portfolios through internal management will be consistent with the tobacco-free benchmark selected by the Investment Committee.

Fourth, the FTSE benchmark currently utilized by Staff includes 90% of the available market capitalization, while the EAFE benchmark used by SSGA to manage the Affiliate Funds only includes 85% of available market capitalization. Throughout our history, Wilshire has always argued that the most inclusive benchmarks are the best benchmarks. As a result, we believe that the FTSE's broader market capitalization is an improvement over the EAFE benchmark.

One of the alternatives proposed by Staff is to hire an external manager and we have found Staff's estimation of an approximate cost of 5 basis points for external management of these funds to be accurate. We believe that this cost is unnecessary, as Staff is fully capable of managing these funds in-house.

The other alternative proposed by Staff would be to manage a separate internal index fund, benchmarked to the EAFE index. As outlined above, we believe that the FTSE and EAFE benchmarks are quite similar, and the small differences between them favor the use of the FTSE. As a result, we believe that a separate EAFE portfolio would be an unnecessary use of Staff's time.

Conclusion

Wilshire agrees with Staff's recommendation to manage the Affiliate Funds as part of the PERF, benchmarked to the FTSE index. Furthermore, we believe that the two alternative solutions proposed by Staff are less attractive in terms of either cost or Staff's time.

Sincerely,

Michael C. Schlachter, CFA